



Perspective on Recent Stock Market Volatility

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Stock market volatility has been in the headlines the past few months. Should investors be alarmed? Historical perspective suggests there is little reason for alarm. Instead, the recent surge in volatility should be a reminder to always be prepared for the emergence of the next period of volatility.

First, consider daily market moves. I will use the return of the S&P 500 Index as a proxy for the US stock market and focus on the absolute value of index return to capture both up and down market movements. During the fourth quarter of 2018, the largest daily move in the US market was a 4.96% gain on December 26th. Compared against the more than 5,000 daily returns of the S&P 500 during the past 20 years, it ranks as the 27th largest in magnitude. To put that in perspective, during the month of October 2008 there were three days where the magnitude of the S&P 500 return exceeded 9%. During the fourth quarter of 2008, there were 16 days where the magnitude of the S&P 500's return exceeded 5%. The extreme volatility of 2008 was a cause for concern as it was driven by fears that the global financial system was collapsing. Today's concerns are much more manageable than 2008.

Next, consider how the average daily volatility of the S&P 500 during the fourth quarter of 2018 compares to other quarters of the past 20 years. I measured volatility as the average of absolute daily returns during each quarter. During Q4 2018, the average absolute daily return of the S&P 500 was 1.11%. This was only the sixteenth highest during the past 20 years. It was well below the 3.31% of Q4 2008 and the 2.04% of Q1 2009. In terms of magnitude, the volatility of Q4 2018 was slightly less than that observed during the collapse of the technology bubble in 2000 (1.18% during Q1 2000 and 1.20% during Q2 2000).

Average daily volatility during 2018 overall was near the median for the past 20 years. I measured volatility as the average of absolute daily returns during each year. During 2018, the average absolute daily return of the S&P 500 was 0.74%. This was only the tenth highest during the past 20 years. Well below the 1.74% of 2008 and 1.23% of 2009. Also trailing the 1.06% of 2000.

Compared against the past 20 years, the volatility of 2018 does not appear unusual. However, narrowing focus to the last seven years changes things. The average absolute daily return of 1.11% during Q4 2018 was the highest quarterly volatility of the past seven years and the 0.74% average absolute daily return for 2018 was the highest annual volatility for the same period.

The comparison is even more dramatic if one focuses on only the two most recent years. The average absolute daily returns for the four quarters of 2017 were the four lowest quarterly values observed during the past 20 years. The average absolute daily return for the second quarter of 2018 was the sixth lowest of the past 20 years. Set against these values, it is not surprising that the volatility of Q4 2018 seems extreme. However, returning to a longer term perspective it is clear that the true outlier was the unusual calm that prevailed in the stock market during 2017.

Trustees should maintain a long term perspective. When markets are unusually calm, be sure your portfolio is ready for the inevitable return to volatility.

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